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Indonesia Infrastructure Conference and Exhibition

# Government Support to Enhance the Viability and Bankability Of PPP Infrastructure Projects

H.E. Sri Mulyani, Minister of Finance

**Distinguished Guests, Ladies and Gentlemen,**

It is my honor and pleasure today to describe for you the Government's policies for enhancing the viability and bankability of private infrastructure projects, to outline how these are being implemented, and to discuss some of the complex challenges we are now tackling.

Presidential Regulation 67 of November 2005 empowers the Government to provide two types of support for Public-Private Partnership (PPP) projects, namely:

- **direct support** for projects that are justified on economic and social grounds but that will not be financially viable without pre-agreed Government fixed contributions;
- **contingent support or guarantees** for certain types of risk that cannot be efficiently managed and mitigated by private investors and lenders.

These are not mutually exclusive, and the Government may accept certain project risks in addition to providing direct financial support. However, today I will be focusing solely on Central Government risk-sharing support.

PerPres 67 requires in this context that:

- risks be allocated to the party best able to control them in order to ensure efficiency and effectiveness;
- granting of Government support must have regard to the principle of controlling and managing risks in the State Budget;

The Minister of Finance is responsible for controlling and managing project risks, and is empowered to decide the criteria for granting Government Support and to approve or reject Support requests for individual projects.

PerPres 67 places strong emphasis on transparency and openness, and fairness, and accordingly requires that all proposed PPP projects:

- be supported by, among others, a pre-feasibility study and a public consultation process; and
- be awarded through an open tender process, even where the project originates from an unsolicited proposal.

The Ministry of Finance established a Risk Management Committee in October 2005, with its two main tasks being to develop criteria and procedures for project risk sharing, and to criteria and procedures were issued in May 2006 as Minister of Finance Regulation PMK 38 of 2005. This empowers Government to bear or share three main types of risk, namely **Political Risk**, **Project Performance Risk**, and **Demand Risk**.

PMK 38 provides for two main forms of compensation in the event such risks materialize, namely concession period extension and/or cash payment.

Requests for Government contingent support are evaluated on the basis of four criteria or principles, namely **Legality**, **Project Quality**, **Affordability,** and **Transparency.** KKPPI is responsible for evaluating technical and financial feasibility, following which MOF evaluates the case for Government risk sharing having regard to the affordability and transparency criteria. I would note here that MOF is currently being restructured, with one important change being to establish a Risk Management Unit to take over the duties of ~~the~~ Risk Management Committee.

**Distinguished Guests, Ladies and Gentlemen,**

Let me now turn to the Infrastructure Guarantee Fund, which we plan to establish by mid-2007. As indicated earlier, the Government is prepared to provide guarantees for certain risks, and recognizes the need to be able to approve multi-year support for individual PPP projects outside of the rigid State Budget cycle. I am pleased to be able to announce that a total of Rp 4 trillion has already been set aside from the 2006 and 2007 budgets for Guarantee Fund and the proposed Infrastructure Investment Fund.

I would also like to take this opportunity to highlight the Government's recently adopted policy on Public Service Obligations or PSOs. As in many other countries, the Government sometimes requires SOEs to provide basic services that are unprofitable. Until recently, such Public Service Obligations or PSOs were mostly funded indirectly through 'hidden' input subsidies. Such practices impaired transparency and accountability, and also hindered efforts to benchmark and improve SOE performance.

In their place, we are now implementing an explicit PSO compensation policy as mandated by the 2003 Law on State-Owned Enterprises. This requires Government to compensate SOEs directly for the full costs of their PSOs. Implementation of the new policy is being pioneered for PT PLN, the State electricity company, which is required to supply power at the tariffs set by Government.

Under the operating guidelines and procedures issued in November 2005, electricity subsidies are channeled through PLN to electricity consumers in those tariff categories for which average selling price is below supply cost. The amount of the subsidy for each tariff category is calculated based on the difference between the prevailing tariff and the computed cost of supply.

All important costs are eligible for inclusion in the subsidy / PSO calculation, including those for PLN's electricity purchases and debt service.

The new policy is already being implemented for PLN, with an amount of Rp35.5 trillion having been approved in the amended 2006 Budget. We have also started to apply the PSO policy for other infrastructure SOEs--including the State railway company--- and intend to progressively refine the guidelines and procedures based on the lessons of experience.

Let me outline some of the many complex challenges we are facing and briefly indicate how we envisage tackling these over the coming months. Our most pressing problem is what I will describe here as 'non-compliant projects'. By this I mean projects that have already progressed to an advanced stage, but which do not meet the preparation requirements specified in PerPres 67. I should emphasize here that 'non-compliant' does not necessarily mean 'bad', and indeed that many non-compliant projects are inherently sound and of high priority. We are accordingly now developing a process under which selective preparation dispensations or waivers can be granted in a fully transparent and accountable manner based on clearly defined criteria and procedures.

Closely linked to this problem are the issues of poor project preparation and Central Government Support for sub-national projects. As regards the former, let me acknowledge on behalf of my Ministerial colleagues that many of the projects so far offered for private participation have not been prepared to the standards expected by international investors and lenders. This is due in part to the intense pressures on us to move quickly, and to the inexperience of some of our institutions. We know we need to do better, and I am pleased to announce we are now establishing a Project Development Facility and will use this to prepare future projects to best practice standards.

PerPres 67 does not deal with Central Government Support for sub-national projects. While we see a case for enabling the Center to provide support in certain circumstances, we also recognize this will require very careful management. Our current thinking is that a separate Presidential Regulation will be needed to define procedures and criteria for deciding project eligibility and risk sharing, with regional government fiscal capacity likely to be an important factor.

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Another important process issue for MOF concerns the reporting and provisioning of contingent obligations in the State budget, and in particular enabling Parliament to play its rightful role with delaying projects. We expect the infrastructure guarantee fund will play an important role here as it will enable Parliament to participate in setting the aggregate resource envelope for guarantees while enabling KKPPI and MOF to make decisions on its allocation to individual PPP projects.

Finally I should mention that one of my most pressing concerns right now is to strengthen the capacity of MOF's Risk Management Unit to deal with the heavy demands already being placed upon it. The organization structure has been finalized, and next week I will start appointing chairman of this unit. I am strongly committed to developing the capacities and governance arrangements of this unit as quickly as possible as it will play a crucial role in our PPP framework. We will accordingly be drawing on the technical support provided by our international partner agencies. RMU is the key institution within the Ministry of Finance to evaluate request of government support and make recommendation to me based on the report of project quality and technical feasibility from KKPPI. When an in-principle approval is granted, this must be disclosed in the state budget and a funding provision made if appropriate.

In closing, let me say I'm fully aware that MOF is in danger of being seen as the 'bad guy' in the PPP chain. Indeed, I suspect we are already viewed in this way! Let me assure you that this is not the role MOF sees for itself, and that we stand firmly behind the objective of facilitating provision of infrastructure so as to accelerate economic growth while ensuring fiscal sustainability. The steps I have outlined above are intended to help us do this in a responsible, accountable and transparent manner.

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